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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1961

No. 326

JULIUS MENDELSON and
PEARL MENDELSON, his wife,

Petitioners-Appellants,

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent-Appellee.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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To the Honorables, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Julius Mendelson and Pearl Mendelson, his wife, Petitioners herein, pray that a Writ of Certiorari be issued to review the order and decision of the Circuit Court of Appeals for the Seventh Circuit affirming the decree and decision of the Tax Court of the United States, the Court of Appeals' decision being dated July 17, 1962; said case involving tip income as a part-time waitress for the years 1957 and 1958, assessed by the respondent appellee under Section 446 of the Internal Revenue Code (Title 26 U.S.C.A. Sec. 446) of 1954.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit in this case has not yet been published, but it is copied in Appendix A (post P. 21).

JURISDICTION TO REVIEW

Jurisdiction of this court is invoked under Section 1254, Title 28, U.S.C.A., Judiciary and Judicial Procedure, subsection (1).

QUESTIONS PRESENTED FOR REVIEW

1. Whether due process and equal protection of the law has been denied these petitioners under the United States Constitution, by Articles V and XIV of the Amendments and Article I, Section 9 of the Wisconsin Constitution; in that the formula of the government was without rational foundation or a sound mathematical basis and, therefore, excessive and conjectural and must fall.

2. Whether the decision of the United States Court of Appeals is subject to reversible error; if the records of the restaurant which the Court of Appeals based its decision on were not supported by the sworn testimony of not only the government witnesses, but by the taxpayer petitioner herself.

3. Whether the Supreme Court of the United States will grant Certiorari to review a decision involving a federal question of substance not heretofore determined by the Supreme Court, and affecting every citizen of the United States.

CONSTITUTIONAL PROVISIONS AND STATUTES OR REGULATIONS INVOLVED

Articles V and XIV—Amendments to the United States Constitution provide:

> "No person shall be deprived of life, liberty, *or property* without due process of law." (Italics ours)

Wisconsin Constitution Article I, Remedy for Wrongs, Section 9:

> "Every person is entitled to a certain remedy in the laws for all injuries, or wrongs which he may receive in his person, *property, or character;* he ought to obtain justice freely, and without being obliged to purchase it, completely and without denial, promptly and without delay, conformably to the laws." (Italics ours)

Section 446 of the Internal Revenue Code (Title 26 U.S.C.A. Sec. 446) provides:

> "* * * * the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, *does clearly reflect income.*" (Italics ours)

STATEMENT OF THE CASE

The petitioner-appellant worked as a waitress at the El Dorado Restaurant in the City of Wauwatosa, County of Milwaukee, State of Wisconsin, in the years 1957 and 1958. The respondent-appellee is claiming that the petitioner, Pearl Mendelson, earned total tips for 1957, in the amount of $3123, whereas petitioner reported only $200. Respondent-appellee further is alleging that petitioner earned total tips in the year 1958 in the sum of $3470, whereas petitioner states she had received none. Petitioner-appellant is further appealing from the five

(5%) per cent negligence penalty asserted in accordance with Section 6653 of the Internal Revenue Code of 1954 originally in the sum of $31.92 for 1957, and originally in the sum of $43.51 for the year 1958.

Petitioner is appealing to this Court from the decision entered by Judge G. G. Withey on January 18, 1962, in the Tax Court of the United States in which it was ordered and decided that there are deficiencies in income taxes due from the petitioners for the taxable years 1957 and 1958 in the amounts of $536.56 and $717.23, respectively; and petitioner is further appealing from the order and decision of Judge Withey regarding the tax penalty under the provisions of Section 6653(A) of the Internal Revenue Code of 1954, in the amounts of $26.83 and $35.86, respectively, for the years involved.

Petitioner, Pearl Mendelson, a waitress, being the subject of this case, is claiming pursuant to the Petition filed in the Tax Court and from the actual facts, and the transcript of testimony in this case shows to this Court that petitioner made no more in tips than reported on her returns, and through her attorneys, requests the court to rule that petitioner's tax returns be accepted as filed; or in the alternative that a more equitable and more factually honest assessment be made reducing the tax due figures of the Tax Court in this case.

Petitioners-appellants are appealing from the Court of Appeals' decision and judgment affirming the U. S. Tax Court decision in this case.

BASIS FOR FEDERAL JURISDICTION IN THE COURT OF FIRST INSTANCE

Petitioners' tax returns were filed for the years in question with the Collector of Internal Revenue for the

Eastern District of Wisconsin, being within the jurisdiction of the United States Court of Appeals for the Seventh Circuit, and the original petition for review filed pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954. Further basis for jurisdiction of this court is Section 1254, Title 28, U.S.C.A. Judiciary and Judicial Procedure, subsection (1).

ARGUMENT TO SUPPORT ALLOWANCE OF THE WIRT

The fundamental precepts of the Federal Constitution of the United States and all laws and regulations passed in conformity therewith, protect fully all peoples, regardless of race, color or creed, to preserve to them their basic rights so that no arm of the government can deny due process and equal protection of the laws to all, which our founding fathers so righteously cherished.

The attempt of the government to use a faulty basic formula or procedure here, attempts to take petitioners' property without just cause.

The power given to the Supreme Court to review cases in which the decision of the Court of Appeals is made final,

> "* * * was intended to vest in this court a comprehensive and unlimited power. The power thus given is not affected by the condition of the case as it exists in the Court of Appeals. It may be exercised before or after any decision by that court, and irrespective of any ruling or determination therein. * * * While this power is coextensive with all possible necessities and sufficient to secure to this court a final order over the litigation in all the courts of appeal, it is a power which will be sparingly exercised, *and only when the circumstances of the case satisfy us that the*

importance of the question involved, the necessity of avoiding conflict between two or more court of appeals, or between courts of appeal and the courts of a state, *or some matter affecting the interests of this nation in its internal* or external relations, *demands such exercise.*" (Italics ours)

Forsyth v. Hammond, Ind. 1897, 17 S. Ct. 665, U.S. 506, 41 L. Ed. 1095.

The Supreme Court would grant certiorari to review a decision involving a federal question of substance not theretofore determined by the Supreme Court. (Italics ours). *Brooklyn Sav. Bank v. O'Neil*, N.Y. 1945, 65 S. Ct. 895, 324 U.S. 697, 89 L. Ed. 1296, rehearing denied 65 S. Ct. 1189, 325 U.S. 893, 89 L. Ed. 2005.

The rule that concurrent findings of fact by two courts below will not ordinarily be disturbed, will not be applied strictly. *Thomson Spot Welder Co. v. Ford*, Mich. 1924, 44 S. Ct. 533, 265 U.S. 445, 68 L. Ed. 1098.

Review in appellate proceeding extends to findings of fact as well as to rulings on questions of law. *Panama Mail S.S. Co. v. Vargos*, Cal. 1930, 50 S. Ct. 448, 281 U.S. 670, 74 L. Ed. 1105.

The concurrent findings of fact of the District Court and Circuit Court of Appeals are persuasive proof in support of their Judgments, but the rule does not relieve the Supreme Court of the task of examining the foundation for the findings in a particular case. The conclusion that may appropriately be drawn from the whole mass of evidence is not always the ascertainment of the kind of fact that precludes consideration by the Supreme Court, particularly where decision before Supreme Court for review cannot escape broadly social judgments and deference properly due to findings of a lower Court does

not preclude the review of such judgments. *Baumgartner vs. U. S.*, Mo. 1944, 64 S. Ct. 1240, 322 U.S. 665, 88 L. Ed. 1525.

The Court of Appeals' decision is in error because the second last paragraph of the decision based its decision solely on the records which were incomplete and inconclusive, disregarding the sworn testimony of the Government's own witness as follows:

Margaret Campbell, a hostess, was called as respondent-appellee's witness and she testified (record page 113) that waitresses worked in the check room, but she didn't know what percentage tips they received. On cross-examination by Mr. Eisenberg (record pages 115-116)

> "Q. For example, she did some hostess work in '57, she helped out a little at that, where she was just showing people to chairs; is that right? A. If I was off, one of the girls would do that, I don't know if Pearl was one of them or not. Q. Well, so far as you know, she did do some hostess work, to your own knowledge? A. I think quite a few of the girls did some hostess work. * * * Q. She, and you know that of your own knowledge, that she was agreeable to take any kind of work even if it meant that there was no tipping; is that right? A. Yes."

This certainly is testimony of an adverse witness favorable to petitioner herein, warranting reversal of the judgment.

A further important fact is that the Court of Appeals based its decision on *Welch vs. Helvering*, 290 U.S. 111; BUT THIS CASE IS NOT A TIP CASE IN WHICH THE PETITIONER ATTACKS THE GOVERNMENT'S FORMULA AS IN THE INSTANT CASE, and the *Helvering* case only holds that

the Government's formula is presumptively correct and the Petitioner has burden of proving it to be wrong. In the instant case the Petitioner, Mrs. Pearl Mendelson, has met the burden of proof necessary to rebut the presumptions of correctness.

I

The legal authorities cited clearly show to this court that the petitioner's burden is sustained by a clear showing that the government's formula for determination was arbitrary, or erroneous, or without rational foundations, and excessive.

In *Section 446, General Rules on Methods of Accounting (Int. Rev. Code, 1954 as amended), Exceptions:* "If no method of accounting has been regularly used by the taxpayer, or if a method used does not clearly reflect income, the computation of taxable income shall be made under such method as, * * *, does clearly reflect income"; and in *Federal Regulations Income Tax—Methods of Accounting in General,* it states in Section O—Par. 1.446—1(4)(b) Exceptions 1: "If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computations of taxable income shall be made in a manner, which in the opinion of the Commissioner does clearly reflect income." These authorities were used by the government to reconstruct income of tips here, but the following legal authorities place a definite limitation on the method or formula used by the revenue agent.

In the case of *Wasson, et al. vs. U. S.,* 51 A.F.T.R. 1723, affd. Federal 2nd; A.F.T.R. 2nd 564, the Supreme Court of the United States laid down the now well established rule that the commissioner has wide discretion in

determining the method of accounting where the books do not reflect a definite method or clearly do not reflect income.

The next pertinent question is whether there are any limitations, and if so what are those limitations. The general basic limitation upon the exercise of the Commissioner's discretion under the pertinent sections quoted, is set forth under the case of *Helvering, Commissioner of Internal Revenue vs. Taylor* (1935) 293 U.S. 507, 515, 55 Supreme Court, 287, 291, 79 Lawyers Edition 623. The facts of this case concerned a dispute as to the apportionment of costs in determining the costs and base between preferred and common stock issued jointly in exchange for stocks surrendered to another corporation. The taxpayer contended that the common stock had no value and the Commissioner determined that it had for the purpose of determining capital gains or losses under the Internal Revenue Code. The Court set forth the general rule as follows:

> *"We find nothing in the Statutes, the rules of the board or our decisions that gives any support to the idea that the Commissioner's determination, shown to be without rational foundation and excessive, will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the correct amount.*—Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid." (Italics ours)

Now the case of *Greenwood vs. Commissioner* (9th Circuit) 134 Fed. 2nd 915, 919, 30 A.F.T.R. 1319, further defines the legal limitations on the exercise of the Commissioner's discretion. The facts of that case were that the deceased taxpayer owned all the property purportedly passing to his wife upon his decease and

as such would be subject to the federal estate tax law unless an agreement for the rental of a certain deposit box containing evidences of title to personal property and real property transmitted into a joint tenancy with respect to the property covered in the documents contained therein. The wife apparently had furnished no consideration toward the purchase or acquisition of any of the property. Accordingly the taxpayer's estate would be taxed in full unless the agreement with respect to the rental would show a joint tenancy in the entire property. The pertinent agreement reads as follows:

> "We the co-signers, joint renters, ... hereby declare and represent that we are joint tenants, with the right of survivorship, all the property now within such box and that all property which may be deposited therein by either or any of us shall be owned by us as joint tenants."

The checking account was also in the name of both parties including the deceased with a writ of survivorship. The Court in the determination of this issue stated the general rule as follows:

> "Unquestionably, the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid. Halvering vs. Taylor, (1935), 293 U.S. 507, 515; 55 Supreme Court 287, 291, 79 Lawyers Ed. 623, *which burden is sustained by a clear showing that the determination was arbitrary or erroneous.* Forbes vs. Hassett, (1 Cir.) 1942, 124 Federal Second, 921, 928."

The case just cited of *Forbes vs. Hassett* (1 Cir.) 1941, 124 Federal 2nd 925, 920, 928, has the following pertinent facts:

The Statute provided for a valuation of the gross estate of the deceased at the time of his death for the

purpose of imposing a Federal estate tax. Taxpayer contends that both the Commissioner and the Court below erred because they failed to consider in addition to the Company's "net worth", its "earning power, dividend paying capacity, and all relevant factors having a bearing on the value of the stock." This is a suit to recover the tax already paid—a refund suit. The court set forth the following relevant rule:

> "Unquestionably, the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid, Helvering vs. Taylor, 293 U.S., 507, 515, 55 Supreme Court, 287, 291, 79 L. Ed. 623, and it appeals or petitions for review from orders of the Board of Tax Appeals. This burden is sustained by the taxpayer when he has shown the Commissioner's determination is *arbitrary and erroneous.* Helvering vs. Taylor, supra; Taylor vs. Commissioner, (2 Cir.) 70 Fed. 2nd 619; Laird vs. Commissioner, (3 Cir.) 95 Fed. 2nd 598; Weber vs. Rasquin (2 Cir.) 101 Fed. 2nd, 62; Guggenheim vs. Helvering, (2 Cir.) 117 Fed. 2nd 469."

The case of *Timmons vs. Commissioner* (4 Cir.) (1952), 198 Fed. 2nd, 142, 42 A.F.T.R. 324, presents a further limitation on the Commissioner's exercise of his discretion under the pertinent provisions of the Internal Revenue Code. Now the facts of this case were that the taxpayer did not keep books showing rentals and rental expense. She reported a figure the Commisioner determined inadequate and refused to aid government agents in any way. The Commissioner determined an assessed deficiency in excess of her figures plus penalty. However, he did not set forth the facts in his deficiency letter showing on what he based his final conclusion of assessment. The Court set forth the pertinent rule in the following language:

> "The Court has made no findings of fact with regard to this matter, however, and the Commis-

sioner has set forth no such facts in his deficiency letter. It is manifestly, not sufficient that we be told merely that 'the tax agent reconstructed her income as best they could'. The court should have found the facts upon which construction was based so that we could judge whether or not it was properly made. *It is well settled that there must be findings, stated either in the Court's opinion, or separately, which are sufficient to indicate the factual basis for the ultimate conclusion.*" (Italics ours)

Now to bring these general rules down to a case involving tips or waiter's tips, we shall refer you to the case of *Nazzarino D. Cessanelli, Petitioner et al, vs. Commissioner of Internal Revenue*, 8 T.C. 776 (1947). The facts of this case was that the government alleged the deficiency in the tax of a waiter by virtue of his failure to include tips to the extent of 10% of the income. Bear in mind that a fellow witness and fellow employees testified otherwise on the basis of a check by the government's agents and personal computation and records they kept. There was a direct conflict in testimony between the petitioner's witnesses and the government's witnesses. The petitioner's witnesses throughout contended that 5% in lieu of tips should be assessed against the gross income whereas the government testified that the figure should be 10%. There were no other distinguishing facts in this case. The Court stated the general but refined rule based upon the preceding facts in the following language:

"Having observed carefully the witnesses on the stand and then having studied the record we can not avoid the conclusion that the self interest of the petitioner in the outcome of the case colored their testimony, and overcame any scruples they may have had as to telling the truth of the matter. The parrot-like repetition of the 5% figure fails to carry con-

viction that their testimony is to be believed. The testimony of the government witnesses, on the other hand, all with equal opportunity to know the facts but without temptation born of self-interest to color the facts, was that 10% of sales was a fair estimate of the average tip received as verified by actual expenses when records were kept. The testimony commits itself as the truth in the premises — The decision was rendered under Rule 50.

Now we ask the Court to bear in mind that in this case we have simply a difference in fact contentions based upon evidence of fellow waiters who kept records and the petitioning waiter and taxpayer who did not keep records and that is all, whereas in the case at bar, as we shall show subsequently, an entirely different situation is shown by virtue of the fact that they are distinguishing characteristics in our case not present in the *Cessanelli* case.

In the case of *Alfred A. Nahman, Petitioner vs. the Commissioner of Internal Revenue, respondent,* (1930) 2 B.T.A. 121, we have a case in which the government through the Commissioner of Internal Revenue and his deputies and agents and delegates accepted a portion of the figure submitted by the petitioning taxpayer, but rejected others and proceeded to apply a formula based upon their own conclusion which the Court in this case promptly rejected. The facts of the case were that in 1922 and 1923 the petitioner was a member of a partnership in an export brokerage business. The partnership was dissolved in 1924 *and the books of account abandoned.* Commissioner determined the deficiency on the basis of 2% on the sale. The Court stated the rule in the following language:

"Although the abandonment or destruction of books of taxpayer would in many cases raise a suspi-

cion that they were destroyed namely for the purpose of making it impossible to audit them, we are convinced—there was no ulterior motive on the part of the petitioner. The petitioner testified that the partnership business was almost entirely a cash business and that upon liquidation of the partnership there was no accounts to be collected. All of the debts of the partnership were promptly paid in full and the assets divided among the two partners. The petitioners saw no need for retaining the books of account of the partnership and did not have storage space for them.

We are satisfied from the testimony of the witnesses that the books of account were carefully kept and that the returns fully reflect the operation of the partnership. Consequently, we are of the opinion that the position taken by the respondent throughout the course of this proceeding can not be maintained. *The basis of his action apparently has been suspicion, not conviction. It is noted that the respondent accepted the figures of the partnership returns as reflecting sales; but at the same time refused to admit the accuracy of the other figures contained therein. It would appear that the logic of the situation would necessitate the refusal to accept figures representing sales as well his refusal to accept the others. Complete details of the transaction are set forth in the Schedule of the return, but we have had no intimation from the respondent that such transactions were investigated.*" (attention is invited to the fact that the failure of the government to promptly follow all leads and to check evidence not clear is a material fact in determining whether or not the determination of the Commissioner was not arbitrary and excessive but was fair and within his discretion).

"In view of what has been said, we are of the opinion that the petitioner has overcome the prima facie correctness of the determination made by the respondent."

In the cases of *Julius Gomez* cited in par. 59, 142 Prentice-Hall Memo, T.C. opinion, and *Herbert Lucke*, par. 59, 146 Prentice-Hall Memo. T.C. opinion, the Court indicated that a relevant fact to be taken into consideration in determining the reasonableness of the Commissioner's determination was the matter of whether or not the taxpayer *was employed seasonally and whether or not tips were shared.*

Another fact that has received judicial approbation as being a significant and material fact in determining a percentage to be applied to gross income or gross sales is whether or not waiters records were kept prior or anterior to the time period at issue. *Clement Schmitz* 51, 169 Prentice-Hall Memo. T.C. Opinion.

In the case of *Furthing vs. U.S.* (D.C. Miss. 1961) 7 A.F.T.R. 2nd, 944 Affirmed on Appeal in the Federal District on Appeal, the Court held that application of the hourly rate of tips by the Commissioner to determine tip income was arbitrary and reduced the assessment of the Commissioner.

In the case of *Basil C. Meadows*, T.C. Memo. 1959—200, the Commissioner's determination was reduced on the basis of testimony of fellow witnesses and fellow employees.

We respectfully ask the Court to take judicial notice of the following various classifications of waitresses and kindred vocations as listed in the *Dictionary of Occupational Titles prepared by the Division of Occupational Analysis of the United States Employment Service published by the Bureau of Employment Security, United States Department of Labor:*

Table girl, Bar maid, relish girl, waitress-banquet, waitress-cafeteria, waitress-cooks, waitress-

head, waitress-home, waitress-kitchen help, waitress-steam table.

We are asking you to take judicial notice of these classifications with emphasis on their number for the purpose of indicating the extreme difficulty facing the Commissioner or anyone else in determining a rate in percentage form to be applied to gross sales as representative of tips, due to the fact that such occupational classifications so numerous and differing in opportunities to serve the public, renders an application of any hard and fast percentage to waitresses per se inequitable.

The difficulty of equitably determining a reconstruction of accounts and facts clearly reflecting income by the Commissioner and the Courts is set forth in the following article: "Reflecting Income under Sec. 446," 54 Col. L. Rev. 1590 (1954).

Although the cases themselves have indicated some of the relevant factors, and we have cited them as material in determining an accurate percentage to be applied to waitress tips per se, all fact situations are not covered in above cases in determining an accurate percent to be applied to the gross sales handled by a waitress and representative of her tip income, therefore we should like to enumerate what we, in the light of common sense and sound business judgment, consider that the Commissioner and the Court should weigh in determining the reasonableness or the arbitrariness of the Commissioner's determination of the percentage to be assessed to gross sales of a waitress in lieu of taxable tip income if in fact such tips are to be considered as income over the objection of petitioner:

1. The seasonal character of the restaurant business.
2. The amount of tips earned by other restaurants similar in size and location, and character.

3. The various types of duties performed by the taxpayer-waitress in the course of her employment and the relative time spent on each, and the relative opportunity to receive tips on each specific assignment.

4. The presence or absence of corroborating evidence from fellow waitress employees in the same establishment or similar establishments.

5. The difference in opportunities of obtaining tips in various assignments within a given dining room or within a given restaurant or food establishment.

6. The customary practices of patrons of that and similar restaurants as to their habits of tipping, to-wit: the amount they customarily tip waitress by means of a representative sample.

7. No youth to offer.

It is submitted that these tests and criteria should be applied to the relevant facts in our case and should be taken into careful consideration by this court.

II

The factual elements in respect to the government's formula used in the assessment against the petitioner for the years 1957 and 1958 is completely without a true basis as factual foundation, and is excessive and said formula must fall.

The transcript in this case is clear in respect to the formula of the income tax agent in his determination of tips of the petitioner herein. The formula is quoted in the statement of facts hereinabove, and is also in the appendix to this brief.

There are numerous factual elements (as stated in statement of facts), that the revenue agent did not con-

sider, such as kick-backs, poor serving stations, upper level, baseball crowds, part-time waitress (petitioner was), walkouts, dead hours, set-up girl, cleaning girl, and many others as the record in this case shows, which warrant a reversal of the lower court's decision herein.

III

That because of the fallacious formula of the government and the legal authorities cited to invalidate the government's formula or determination, this court should accept the returns of the petitioner as filed for the years 1957 and 1958, or *in the alternative,* this court should set an equitable figure for the years involved in respect to tips for the petitioner, Pearl Mendelson, as shown by the actual facts in this case and not by an incorrect and inadequate formula of the government.

One conclusion and only one conclusion can be derived therefrom, namely, that the assessment of the Commissioner and the decision of the Tax Court has placed an arbitrary, unreasonable, inadequate, erroneous and excessive figure on the amount of tips earned by the petitioner.

We submit that the formula as it has been applied evidenced from the transcript of the record of testimony by government witnesses under cross-examination by counsel for petitioner clearly shows that relevant facts and criteria have been utterly disregarded, and criteria of an arbitrary character has been used in the formulation of the formula applied erroneously. It has resulted in an excessive conclusion of taxes due.

CONCLUSION

In conclusion, the Petitioners respectfully request that this Court grant the Writ of Certiorari so that all questions raised by this Petition may be resolved by this Court since the questions are of great Federal Public Importance which were never resolved or tested by this Honorable Court. The facts in this case are clear and rebut all of the Respondent-Appellee's contentions.

Respectfully submitted.

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Dated: August 10, 1962

APPENDIX A

In the United States Court of Appeals For the Seventh Circuit

SEPTEMBER TERM, 1961, APRIL SESSION, 1962

No. 13675
JULIUS MENDELSON and
PEARL MENDELSON, his wife,
Petitioners-Appellants,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

On Petition for Review of the Decision of the Tax Court of the United States.

July 17, 1962

Before DUFFY, SWYGERT and MAJOR, *Circuit Judges.*

MAJOR, *Circuit Judge.* This case is here on petition for review of a decision of the Tax Court sustaining in part deficiencies determined by respondent in income taxes due from the petitioners for the taxable years 1957 and 1958. Petitioners as husband and wife filed joint returns for those years. The failure to report income concerns only the wife, Pearl Mendelson, who will be referred to as the petitioner or taxpayer.

Respondent determined a deficiency of $638.43 for the year 1957, and an additional tax for negligence in the amount of $31.92, and a deficiency of $870.24 for the year 1958, and an additional tax for negligence in the amount of $43.51. The Tax Court reduced these deficiencies to $536.56 for 1957, and $717.23 for 1958, with negligence penalties of $26.83 and $35.86, respectively.

The unreported income from which such deficiencies were determined consisted of tips received by the taxpayer while serving as a waitress. She reported $200 as income from tipping for 1957, and no income from that source for 1958. Taxpayer worked as a waitress at the El Dorado Restaurant, in the City of Wauwatosa, County of Milwaukee, Wisconsin. She kept no records or books relative to the amount of income received during the taxable years. Under such circumstances, Sec. 446 of the Internal Revenue Code (Title 26 U.S.C.A. Sec. 446) provides:

> "• • the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income."

Pursuant to this authority, respondent formulated a method by which he determined taxpayer's unreported income received from tips, with the deficiencies resulting therefrom.

The principal contention of petitioner is that respondent in determining her income from tips exceeded his legal limitations and that the method employed by him was arbitrary, excessive and without rational foundation. On first impression we thought there might be merit in petitioner's contention; however, after reading the entire transcript of the proceedings before the Tax Court, we are definitely of the conviction that the record furnishes ample support for its findings of fact, as well as its decision based thereon.

The fallacy of petitioner's attack on the findings is that her argument in the main is based upon petitioner's testimony which the Tax Court was not obligated to accept, particularly in view of her self-interest and the numerous contradictions between her testimony and that of other witnesses. It would unduly burden this opinion to recite the findings in detail. A brief summary will suffice.

The El Dorado was an attractive, high-class restaurant on two levels, the upper to seat the overflow from the lower, and occasionally for parties. It was well located, operated a bar, and served both food and drink. During the taxable years, petitioner worked as a part-time waitress. All of the waitresses were rotated to the various stations and all performed the same character of work.

The tipping custom ranged from nothing to more than 15% of the customer's check, with less tipping by customers served on the upper level. During the baseball season, the restaurant served large groups of baseball fans whose expenditures for food were nominal, as well as their tips. In some instances, customers after having been served evaded the waitresses and left without tipping or paying their checks.

The employment arrangement was that waitresses were to give 10% of their tips to the hostess and 10% to the busboy. Occasionally, waitresses were assigned to the duties of hostess and to work in the restaurant's checkroom. Most of the tips received in the checkroom were turned over to the management.

From records of the restaurant respondent obtained a statement of the total food and liquor sales, the portion of liquor sales served at tables, total hours worked by all waitresses inclusive of service as hostess and in the checkroom, total hours worked by all waitresses exclusive of service as hostess and in the checkroom, including those worked by petitioner during the years in question. (The findings set forth the facts with reference to each of these items.)

No guest checks were available showing the amount of food and liquor served by the individual waitresses during the taxable years. There being no records kept, either by the taxpayer or by management, showing the amount of food and liquor served by taxpayer, respondent concluded that the taxable amount of tips received by her during the years in question should be determined in the following manner:

> "First, ascertain the total of the total food sales and the sales of liquor served at tables during the respective years. Second, divide the totals for the respective years by the total number of hours worked by all waitresses as waitresses during the respective years to ascertain the average amount of food and liquor served per average waitress hour. Third, multiply the quotients thus obtained for the respective years by the number of hours the petitioner worked as waitress during such years to ascertain the total amount of food and liquor served by petitioner during

each year. Finally, apply 12 percent to the total sales of food and liquor served by petitioner as thus ascertained so as to ascertain the amount of the petitioner's taxable tips for the respective years. In determining the foregoing amount of 12 percent, the respondent concluded from his survey that a rate of 15 percent was properly applicable to the food and liquor sales served at tables at El Dorado. However, because the waitresses were required to pay a portion of their tips to the hostess and bus boy, the respondent determined 12 percent as a proper percentage to use in order to determine the taxable amount of tips received by petitioner during the respective years."

From this formula, respondent determined that during 1957, petitioner received taxable income from tips in the amount of $3,123, and during 1958, taxable income from the same source in the amount of $3,470. These amounts were reduced by the Tax Court to $2,660 for 1957, and $2,900 for 1958.

We agree with the Tax Court that the method used by respondent in determining petitioner's income from tips was within his statutory power and was not arbitrary, excessive or without rational foundation, as urged by the taxpayer. His method has the support of a presumption of correctness, and the petitioner had the burden of proving it to be wrong. *Welch* v. *Helvering*, 290 U.S. 111, 115.

Relative to the method employed by respondent, we can do no better than quote the reasoning of the Tax Court:

> "As used by the respondent that method gives recognition to the fact that petitioner was an average waitress within her group in that it uses the average amount of food and liquor served by all waitresses per hour worked as waitresses during the respective taxable years as the basis for computing the amounts of food and liquor served by petitioner during such years and to which the respondent applied a rate of 12 percent to ascertain the petitioner's taxable income received from tips for those years. Except as to the foregoing rate of 12 percent, we are of the opinion that the respondent's method as applied to the petitioner is fair and reasonable."

Having determined the total sales of food and drink served by petitioner, it became essential to determine the percent thereof which she received as tips. As shown in the method employed by respondent, he used 12%, which was reduced by the Tax Court to 10%. We agree with the reasoning of the Tax Court in this respect, which is as follows:

> "In arriving at the rate of 12 percent to be applied to the amount of food and liquor sales served by the petitioner, the respondent concluded that a rate of 15 percent was properly applicable to the food and liquor sales served at the tables at El Dorado for the purpose of determining tips. Since the waitresses were required to pay a portion of their tips to the hostess and bus boy, the respondent reduced the 15 percent to 12 percent. The evidence as to tipping at El Dorado shows that tipping ranged from nothing to 15 percent of the customer's check for good service, and to more than 15 percent where the service was exceptionally good. The evidence further shows that there was less tipping by customers served in the upper level than by those served in the lower level and that tipping during the baseball season by large groups of baseball fans was nominal. There also is evidence that where a customer tipped 15 percent of his check when only food was served, he tipped only 12½ percent of his check when both food and liquor were served. Further, there is evidence that in some instances customers, after being served, evaded the waitresses and left without tipping or paying their checks and that in such instances the waitresses were required to pay the amount of the customers' checks. From our consideration of the foregoing we are of the opinion that an application of 10 percent, instead of 12 percent as applied by respondent, to the food and liquor sales served by petitioner during 1957 and 1958 will correctly approximate the taxable income received by petitioner in those years from tips. Accordingly we have found that during 1957 and 1958 the petitioner received taxable income from tips in the amounts of $2,660 and $2,900, respectively."

Petitioner complains that no account was taken of hours worked by her as hostess or checkroom girl. However,

the time cards of the restaurant do not show any hours worked by her other than as a waitress and we think respondent was entitled to give credence to such records rather than accept petitioner's testimony. Petitioner also complains that respondent failed to take into consideration that tipping on the upper level of the restaurant was less, that there was only nominal tipping by baseball fans and that certain customers "skipped" without paying the check or leaving a tip. However, these matters were all taken into consideration by the Tax Court in reducing the tip percentage from 12 to 10.

Obviously, where a taxpayer keeps no records disclosing his income, no method can be devised which will produce an exact result. The law does not require that much. It is sufficient if the method employed produces a result which is substantially correct. All taxpayers, including the one here involved, by failure to keep records of their income assume the hazard that they may be called upon to pay a tax based on an income which cannot be determined to a certainty. Such a situation, however, arises from the fault of the taxpayer and not that of the Commissioner.

The decree on review is

AFFIRMED.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit.

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 326

JULIUS MENDELSON and PEARL MENDELSON, his wife, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 34-43)[1] are not officially reported. The opinion of the Court of Appeals (Pet. 21-26) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on July 17, 1962. The petition for a writ of cer-

[1] References designated "R" are to the appendix to petitioners' brief in the Court of Appeals.

tiorari was filed on August 13, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Tax Court's determination of taxpayer's income derived from tips was arbitrary and unreasonable.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 446. GENERAL RULE FOR METHODS OF ACCOUNTING.
>
> * * * *
>
> (b) *Exceptions.* If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.
>
> * * * *

STATEMENT

The facts, part of which were stipulated (R. 14-26, 32-34), may be summarized as follows:

During 1957 and 1958, petitioner, Pearl Mendelson,[*] was employed as a part-time waitress at the

---

[*] Petitioners filed joint income tax returns for the taxable years in issue. Inasmuch as petitioner Julius Mendelson appears as a party only because of this fact, he will not be referred to hereafter.

El Dorado Restaurant in Wauwatosa, Wisconsin (R. 35). The restaurant, which featured liquor, steak and seafood, served lunch for $1.15 and dinners ranging from $2.75 to $5.50 (R. 36). It had a lower level, and an upper level used to seat the overflow crowd as well as occasional parties (R. 35).

When petitioner reported for work, she was assigned a station of four or five tables and served both food and liquor to her customers (R. 36). Her pattern of work was similar to that of the other waitresses at the El Dorado. Before the busy hours, she would set up her tables and clear her station. She served customers at lunch from approximately noon until 2:00 p.m. After that, she cleaned her station, checked out and went home. At the dinner hours, a similar procedure was followed. It was the practice to rotate waitresses among different stations, and petitioner was not stationed on the upper level more frequently than the other waitresses (R. 36). Although some of the waitresses performed hostess duties and occasionally were assigned to the restaurant's checkroom, petitioner was employed solely as a waitress during both of the years in issue (R. 37, 41). She was an average waitress among a group of waitresses, all of whom were good (R. 36).

The records of the El Dorado indicate that in 1957 she worked a total of 1,409 hours; in 1958, she worked 1,582 hours (R. 38). Her wages as a waitress during these years ranged from $.70 to $.75 per hour (R. 37), and she reported income from wages of $1,172.76 and $1,345.95, respectively (R. 35). For 1957, petitioner reported income from tips in the

sum of $200. She reported no such income for 1958 (R. 35).

The tipping practice at the El Dorado depended primarily on the quality of the service and the quality of the food. Tips ranged from nothing to more than 15% of the bills. Tipping was higher on the lower level of the restaurant than on the upper level. In some instances, customers left without paying their checks or tipping. During the baseball season, the restaurant served large groups of fans who ordered little food and accordingly left only nominal tips (R. 37).

Petitioner herself maintained no records concerning her restaurant employment (R. 38). The restaurant's records indicated the following (R. 38):

	1957	1958
Total food sales	$298,026	$301,039
Total liquor sales	130,440	128,330
Portion of liquor sales served at tables	78,264	76,998
Total hours of all waitresses, inclusive of time as hostess and in checkroom	23,082	23,155
Total hours of all waitresses, exclusive of time as hostess and in checkroom	19,949	20,621
Total hours worked by petitioner as waitress	1,409	1,582

Because figures showing the amounts of food and liquor served by each waitress were unavailable for 1957 and 1958 (R. 39), the Commissioner determined the amount of tips received by the petitioner in each of those years in the following manner. First, he added together total food sales and liquor sales

at the tables. This sum was then divided by the total hours worked by all waitresses as waitresses to determine the average amount of food and liquor served per average waitress-hour. Next, this quotient was multiplied by the total number of hours worked by petitioner as a waitress to find the total amount of food and liquor served by her during each taxable year. Finally, a rate of 12% was applied to this last amount to determine her tips for the year. Although the Commissioner determined that a rate of 15% was properly applicable to the tipping situation at the El Dorado, he reduced the rate to 12% to take account of the portion of their tips waitresses were required to pay over to the bus boy and to the hostess (R. 39). Under this formula, the Commissioner determined that petitioner had received $3,123 in tips during 1957 and $3,470 during 1958. (R. 39-40.)

The Tax Court accepted as fair and reasonable the method used to determine the amounts of tips received by petitioner (R. 42). In the light of evidence showing fluctuation in the general tipping percentage, less tipping on the upper level of the restaurant, nominal tipping by baseball fans, occasional skipping by customers without paying checks or leaving tips, and reduced tipping on combined food and liquor checks, the Tax Court concluded that a rate of 10% rather than 12% would correctly approximate the amounts petitioner received. Using 10%, the Tax Court determined that during 1957 and 1958 petitioner received income from tips of $2,660 and $2,900, respectively (R. 43).

A decision was entered (R. 48) by the Tax Court determining deficiencies in income taxes due for 1957 and 1958 of $536.56 and $717.23, respectively, together with penalties of $26.83 and $35.86, respectively.

Petitioners sought review of this decision, and the Court of Appeals affirmed (Pet. 21-26), holding that the method employed by the Commissioner to determine petitioner's income from tips was within his statutory power, and that the decision of the Tax Court was amply supported by the record.

ARGUMENT

When the taxpayer keeps no records the Commissioner is directed to compute taxable income under such method as, in his opinion, "clearly reflect[s] income". I.R.C. 1954, § 446(b), *supra*. The method used here was reasonably calculated to show petitioner's income from tips during the taxable years in issue.

1. In attempting to reconstruct petitioner's income from tips for 1957 and 1958, the Commissioner was faced with the fact that she had kept no records which reflected these amounts. Furthermore, neither the petitioner nor her employer had any records which would show the total amount of food and liquor billed to customers by petitioner in either year. Under these circumstances, it was proper for the Commissioner to use any practical method available to determine her tip income, including circumstantial proof. *United States* v. *Doyle*, 234 F. 2d 788 (C.A. 7th).

The method employed relied upon stipulated records maintained by the El Dorado Restaurant. Essentially, the Commissioner determined petitioner's tip income in two steps: (1) a computation of the total amount of food and liquor presumably served by her during each year; and (2) application of the local tipping percentage to her total billings for each year. In the absence of records showing the sales of each waitress, the Commissioner's method of arriving at the first figure was plainly reasonable. It approximated, as nearly as was possible, the dollar volume of petitioner's sales over the years in question. The tipping percentage applied accurately reflected the custom prevailing at the establishment.

Despite her blanket complaint (Pet. 5) that this is a faulty procedure, petitioner is unable to show that it is unfair or unreasonable. Nor does she suggest a better method. It is well settled that Section 446(b) does not require that the Commissioner's computation be entirely free from error. *Huntington Securities Corp.* v. *Busey*, 112 F. 2d 368 (C.A. 6th). The Commissioner has broad discretion to adopt a method which he believes will clearly reflect the income of the taxpayer, and his selection must stand unless petitioner can make a clear showing that he abused his discretion. *Lucas* v. *American Code Co.*, 280 U.S. 445, 449; *Standard Paving Co.* v. *Commissioner*, 190 F. 2d 330 (C.A. 10th).

2. The main thrust of petitioner's argument is directed against the findings of fact. But this argument is necessarily confined to matters not covered by the stipulations. As already noted, the records maintained by petitioner's employer were admitted

(R. 14, 38). These included total food and liquor sales, as well as the number of hours petitioner worked as a waitress.

The contention is made (Pet. 17-18) that the Commissioner failed to take into account certain factors tending to reduce the amount of tips received. However, as the Tax Court's opinion makes clear (R. 42-43), the Commissioner had allowed for kickbacks to bus boys and hostesses, and the tipping rate was further reduced to 10% by the Tax Court itself when it found that other evidentiary factors had not been given sufficient weight. This same contention was made in the Court of Appeals and rejected (Pet. 26).

Petitioner also claims (Pet. 7) that the testimony of the Commissioner's witness, Margaret Campbell, was disregarded. But the Tax Court was entitled to rely on the stipulated facts which indicated that petitioner spent no time as a hostess or in the checkroom (R. 33-34). And, in any event, the testimony cited (Pet. 7) shows that Margaret Campbell was uncertain whether petitioner had acted as a hostess in 1957.

3. There is no conflict of decisions. The question involved is simply whether the record supports the Tax Court's decision. Contrary to petitioner's assertion (Pet. 19), there is no important question of federal law to be settled. Petitioner, instead, merely seeks a review of the evidence and the inferences to be drawn from it. *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175.[2]

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[2] Petitioner also states (Pet. 4) that she seeks review of the additions to the tax imposed under Section 6653(a) of

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Solicitor General.

LOUIS F. OBERDORFER,
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Attorney.

September 1962.

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the 1954 Code. These penalties, amounting to 5% of the underpayment in tax for each year, were sustained by the Tax Court since petitioner had failed to keep any record of the tips received in 1957 and 1958. Petitioner having introduced no evidence to rebut the Commissioner's determination that the additions were properly owing, they are not now subject to review.

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